Supreme Court, U.S.
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No.

In The
Supreme Court of the United States

JOE D. KINLAW,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court of Appeals
For the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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79 pp

QUESTIONS PRESENTED FOR REVIEW

1. Did the Fifth Circuit err in ignoring its own precedent by failing to conduct a *de novo* review of the District Court's Judgment, which denied Kinlaw's Rule 60(b)(4) Motion to Vacate for lack of subject matter jurisdiction?

2. Once the District Court ruled, after a trial on the Securities and Exchange Commission's enforcement action, that the instruments in question were not securities, did the District Court err in invoking subject matter jurisdiction and entering a Final Judgment enjoining Kinlaw from future federal securities law violations?

PARTIES TO THE PROCEEDING

The following were parties in the court of appeals' proceeding:

Joe D. Kinlaw
Steven R. Parker
Securities and Exchange Commission

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The opinion of the Court of Appeals (App. 1a) is unpublished, as noted at 254 F.3d 1080. The opinions of the district court are unreported. (App. 2a, 8a).

JURISDICTION

The United States Court of Appeals for the Fifth Circuit entered its Judgment affirming the Judgment of the District Court for the Northern District of Texas on May 14, 2001. (App. 1a). A timely Petition for Rehearing was denied by the Fifth Circuit on July 9, 2001. (App. 40a). In accordance with Supreme Court Rule 13, this Petition for Writ of Certiorari is filed within ninety (90) days after entry of the Judgment denying Kinlaw's Petition for Rehearing.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES AND RULES INVOLVED[1]

1. Securities Act of 1933 - 15 U.S.C. § 77b(a)(1)

Definitions; promotion of efficiency, competition, and capital formation

(a) Definitions

When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

2. Securities Act of 1933 - 15 U.S.C. § 77e(a)

Prohibitions relating to interstate commerce and the mails

(a) Sale or delivery after sale of unregistered securities

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

---

[1] The text of the statutes set forth below are as they existed at the time of trial.

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for the delivery after sale.

3. Securities Act of 1933 - 15 U.S.C. § 77e(c)

(c) Necessity of filing registration statement

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

4. Securities Act of 1933 - 15 U.S.C. § 77q(a)

Fraudulent interstate transactions

(a) Use of interstate commerce for purpose of fraud or deceit

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements

made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

5. Securities Act of 1933 - 15 U.S.C. § 77v(a)

Jurisdiction of offenses and suits

(a) Federal and State courts; venue; service of process; review; removal; costs

The district courts of the United States and the United States court of any Territory shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

6. Securities and Exchange Act of 1934 - 15 U.S.C. § 78c(a)(10)

Definitions and application

(a) Definitions when used in this chapter, unless the context otherwise requires—

. . . .

(10)The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

7. Securities and Exchange Act of 1934 - 15 U.S.C. § 78j(b)

Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the

public interest or for the protection of investors.

8. Securities and Exchange Act of 1934 - 15 U.S.C. § 78aa

Jurisdiction of offenses and suits.

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

9. 17 C.F.R. § 240.10b-5

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

10. Rule 60(b)(4) of the Federal Rules of Civil Procedure

Relief From Judgment or Order

(b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.

On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: . . . . (4) the judgment is void . . . .

STATEMENT OF THE CASE

On September 30, 1993, the Securities and Exchange Commission ("SEC") instituted the underlying enforcement action in the United States District Court for the Northern District of Texas against nineteen defendants, including Joe D. Kinlaw ("Kinlaw"), alleging violations of Sections 5 and 17 of the Securities Act of 1933 ("Securities Act") (the securities registration and antifraud provisions, respectively), Section 10(b) of the Securities and Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder (the antifraud provisions). Based upon the SEC's allegations of federal securities laws' violations, the District Court exercised subject matter jurisdiction over the case pursuant to 28 U.S.C. § 1331.

Thereafter, on July 27, 1995, pursuant to a Consent and Undertaking filed with the District Court on July 20, 1995, the District Court entered an interlocutory Order of Permanent Injunction and Other Equitable Relief against Kinlaw (the "Kinlaw Interlocutory Order"). (App. 31a). Sections I through IV of the Kinlaw Interlocutory Order enjoined Kinlaw from violating certain of the federal securities laws. (App. 32a-36a). However, Sections V and VI of the Kinlaw Interlocutory Order addressed matters that were unresolved between Kinlaw and the SEC, namely, the payment of disgorgement and penalties. (App. 36a-37a).

Specifically, Sections V and VI provided, respectively, that the amounts of disgorgement and civil penalty were to be determined at a later date by agreement of the parties or, absent that, by the Court. (App. 36a-37a). The SEC and Kinlaw never reached agreement. Despite that, however, the District Court never held a hearing nor made a determination on disgorgement or penalties.

The SEC proceeded to trial against eight defendants in March 1998. In the trial, the SEC attempted to prove liability against the eight trial defendants for securities violations. (App. 13a-14a). The SEC also sought injunctive relief, disgorgement, and penalties. (App. 14a). The SEC did not, however, try any issues against Kinlaw. Instead, the SEC proceeded to trial against the eight other defendants knowing that Kinlaw was still a party, and knowing that the Kinlaw Interlocutory Order was still outstanding. (App. 31a). The District Court issued Findings of Fact and Conclusions of Law ("Findings and Conclusions") on July 21, 1999. (App. 13a). In its Findings and Conclusions, the District Court held that the joint venture interests, i.e., the instruments in question, were not securities. (App. 13a, 30a). On July 21, 1999, the District Court also issued a Final Judgment (the "Trial Judgment") (App. 12a), which conformed with the District Court's Findings and Conclusions, and dismissed the SEC's claims against the eight defendants who ultimately tried the case (the "Trial Defendants").

Apparently recognizing that the Kinlaw Interlocutory Order, along with certain earlier "judgments," were only interlocutory and not final, the District Court, on July 21, 1999, also issued an Order Concerning Amended Final Judgment (the "Court's Amendment Order") (App. 10a), requesting briefs from the parties, presumably pursuant to Fed. R. Civ. P. 59(e).

In response to the Court's Amendment Order, Kinlaw filed his Motion to Amend the Final Judgment and Memorandum of Points and Authorities in Support Thereof, wherein Kinlaw argued that the District Court lacked subject matter jurisdiction to issue a permanent injunction against him. Kinlaw's argument was based upon the District Court's holding that the joint venture interests at issue were not securities. Despite Kinlaw's objections, on August 6, 1999, the District Court issued an Amended Final Judgment, which included a Final Judgment of permanent injunction against Kinlaw ("Kinlaw Final Judgment"), enjoining him from certain future federal securities law violations. (App. 8a).

On February 2, 2000, Kinlaw filed a Motion to Vacate Final Judgment and Memorandum of Points and Authorities in Support Thereof ("Kinlaw's Rule 60(b) Motion"), (App. 41a) pursuant to Federal Rules of Civil Procedure 60(b)(4), 60(b)(5) and 60(b)(6). Kinlaw's 60(b)(4) Motion was based upon the Court's lack of subject matter jurisdiction to issue a permanent injunction against him.

On April 10, 2000, the District Court issued its Order Denying Kinlaw's Rule 60(b) Motion. (App. 2a). Thereafter, on June 2, 2000, Kinlaw filed his Notice of Appeal with the Fifth Circuit Court of Appeals.

Following briefing of the Parties, the Fifth Circuit held oral argument on May 9, 2001. The Fifth Circuit issued its decision on May 14, 2001, affirming the District Court's judgment. (App. 1a). Because the decision stated that the District Court did not "abuse its discretion" in denying the 60(b) motions, Kinlaw filed a Petition for Rehearing on June 21, 2001, requesting that the Panel rehear Kinlaw's

60(b)(4) Motion and conduct a *de novo* review of the District Court's decision. (App. 51a). The Fifth Circuit denied the Petition for Rehearing on July 9, 2001. (App. 40a). Kinlaw filed this Petition for Writ of Certiorari within ninety (90) days of the Fifth Circuit's final ruling.

REASONS FOR GRANTING WRIT

I. THE FIFTH CIRCUIT APPLIED THE INCORRECT STANDARD OF REVIEW WHEN IT APPLIED AN ABUSE OF DISCRETION STANDARD FOR REVIEWING THE DISTRICT COURT'S DENIAL OF KINLAW'S 60(b)(4) MOTION RATHER THAN A *DE NOVO* STANDARD.

The Fifth Circuit's decision directly conflicts with prior decisions of the Fifth Circuit. More specifically, in the opinion below, the Fifth Circuit held that the District Court did not "abuse its discretion" in denying Kinlaw's Rule 60(b)(4) Motion to Vacate for lack of subject matter jurisdiction. (App. 1a). The Fifth Circuit's application of an abuse of discretion standard directly conflicts with the *de novo* standard of review set forth in prior Fifth Circuit decisions. *See Carter v. Fenner*, 136 F.3d 1000, 1005 (5th Cir.), *cert. denied*, 525 U.S. 1041 (1998) (*de novo* review of ruling on 60(b)(4) motions); *Recreational Prop., Inc. v. Southwest Mortgage Serv. Corp.*, 804 F.2d 311, 314 (5th Cir. 1986) (same); *see also Pederson v. Louisiana State Univ.*, 213 F.3d 858, 869 (5th Cir. 2000) (*de novo* review of jurisdictional questions); *Bogle v. Phillips Petroleum, Co.*, 24 F.3d 758, 760 (5th Cir. 1994) (same). These cases clearly require a *de novo* review of a district court's ruling on a Rule 60(b)(4) Motion to Vacate. In its appellate briefing, the SEC agreed that a *de novo* review was required.

Accordingly, the Fifth Circuit committed reversible error when it applied an abuse of discretion standard to review the District Court's denial of Kinlaw's Rule 60(b)(4) Motion.

In an effort to obtain relief from the error, Kinlaw filed, with the Fifth Circuit, a Petition for Rehearing, wherein Kinlaw requested a rehearing based upon the proper *de novo* standard of review. The Fifth Circuit refused. Had the *de novo* standard of review been applied, the District Court's clear error would have mandated reversal.

II. AFTER THE DISTRICT COURT RULED THAT THE INSTRUMENTS WERE NOT SECURITIES, THE DISTRICT COURT LACKED SUBJECT MATTER JURISDICTION TO ISSUE A PERMANENT INJUNCTION PROHIBITING FUTURE SECURITIES LAW VIOLATIONS.

"Federal courts are courts of limited jurisdiction. They possess only that power authorized by Constitution and statute, which is not to be expanded by judicial decree." *Kokkonen v. Guardian Life Ins. Co. of America*, 511 U.S. 375, 377 (1994) (citations omitted). In the underlying action, the District Court's subject matter jurisdiction was invoked pursuant to 28 U.S.C. §1331, based upon the federal questions raised by the SEC in the underlying enforcement action alleging violations of the Securities Act of 1933, 15 U.S.C. §§ 77e, 77q(a), and the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b). Importantly, federal question jurisdiction exists in a case alleging federal securities laws' violations only if the instruments in question are securities. 15 U.S.C. §§ 77v(a), 78aa. Moreover, it is axiomatic that if a federal court enters a judgment in a proceeding over which it has no subject matter jurisdiction, the judgment is void, the district court has no discretion, and a Rule 60(b)(4) motion to vacate must be granted. *Carter*, 136 F.3d at 1006; *Recreational Prop.*, 804 F.2d at 313. Such is the case here.

On July 27, 1995, the District Court entered the Kinlaw Interlocutory Order—an order that enjoined Kinlaw from future securities violations and an order that left open the amount of penalties and disgorgement Kinlaw

would be required to pay. (App. 31a, 36a-37a). That order remained interlocutory for more than four years, until after a trial on the merits, and after the District Court ruled that the underlying transactions did not involve the offer or sale of "securities." (App. 13a, 30a). Once the District Court found that the joint venture interests were not securities, the only federal statutory basis for the District Court's continued exercise of subject matter jurisdiction vanished. *See* 15 U.S.C. §§ 77v(a), 78aa. Thus, by issuing a Final Judgment enjoining Kinlaw from securities violations, the District Court ignored its own ruling that no "securities" were offered or sold, and effectively expanded, by judicial decree, its very limited jurisdiction. Such a practice runs directly afoul of the Constitution and of Supreme Court precedent. *See generally, Kokkonen*, 511 U.S. at 377.

At the outset, the District Court properly invoked its subject matter jurisdiction in 1995 when it entered the Kinlaw Interlocutory Order. *Bell v. Hood*, 327 U.S. 678 (1946) and its Fifth Circuit progeny so dictate. *See, e.g., Fragumar Corp. v. Dunlap*, 685 F.2d 127, 128-30 (5th Cir. 1982); *Williamson v. Tucker*, 645 F.2d 404, 415-16 (5th Cir. 1981). More specifically, *Bell* and its progeny require that a federal court faced with a subject matter jurisdictional challenge that is also a challenge to the federal cause of action must exercise its jurisdiction and determine the case on the merits. *See Bell*, 327 U.S. at 682; *Fragumar*, 685 F.2d at 128-30; *Williamson*, 645 F.2d at 415. Thus, as occurred in this case, when defendants in an SEC enforcement action file motions to dismiss based upon Rules 12(b)(1) and 12(b)(6), arguing that the instruments at issue are not "securities," with rare exception, *Bell* requires the district court to deny the motions and proceed to a merits determination of the case. *Bell*, 327 U.S. at 682. Accordingly, the District Court's initial exercise of jurisdiction by entering the Kinlaw Interlocutory Order was proper.

Pursuant to the *Bell* line of cases, the District Court also properly proceeded to a trial on the merits of the case,

and, when, after a lengthy trial, it determined that the joint venture interests were not "securities," it dismissed the case on the merits, and not for lack of subject matter jurisdiction. (App. 13a, 30a). *See Fragumar*, 685 F.2d at 128-30. However, the District Court improperly relied upon *Bell*, *Fragumar* and *Williamson* when, after the trial, it entered the Kinlaw Final Judgment, enjoining him from future securities law violations, and when it denied Kinlaw's Rule 60(b)(4) Motion.

Neither *Bell*, *Fragumar* nor *Williamson* involved or addressed the factual and legal issues that arose in this case, namely, whether a court, after a merits determination that the underlying instruments are not securities, can continue to exercise subject matter jurisdiction inconsistent with that determination. Instead, those cases only addressed a district court's jurisdiction to determine the merits of a case; they did not discuss, nor have reason to do so, a district court's exercise of jurisdiction after a merits determination had been made. *See Bell*, 327 U.S. at 682; *Fragumar*, 685 U.S. at 128-30; *Williamson*, 645 F.2d at 415-16. As such, *Bell* and its progeny are inapplicable.

Furthermore, the policies underlying the *Bell* line of cases, as articulated by the Fifth Circuit, have no application to the factual circumstances of this case:

> The Supreme Court has made it clear that . . . no purpose is served by indirectly arguing the merits in the context of federal jurisdiction. Judicial economy is best promoted when the existence of a federal right is directly reached and, where no claim is found to exist, the case is dismissed on the merits. This refusal to treat indirect attacks on the merits as Rule 12(b)(1) motions provides, moreover, a greater level of protection to the plaintiff who in truth is facing a challenge to the validity of his claim . . . .

Williamson, 645 F.2d at 415. The foregoing policies are irrelevant in this case. The District Court entered the Final

Judgment against Kinlaw after trial and, because judicial economy and the protection of the plaintiff were satisfied, those concerns were no longer valid. Accordingly, from both the factual and policy perspectives, *Bell*, *Fragomar* and *Williamson* are inapplicable.

Because of the jurisdictional prerequisites set forth in 15 U.S.C. §§ 77v(a) and 78aa, once a court determines, in an SEC enforcement action, that the instruments at issue are not securities, the district court lacks subject matter jurisdiction to enter injunctive or other ancillary relief. *See, e.g., SEC v. Bennett*, 889 F. Supp. 804, 807-08 (E.D.Pa. 1995)(requiring SEC to submit evidence that the instruments were securities before issuing an agreed preliminary injunction); *see also SEC v. American Realty Trust*, 429 F. Supp. 1148, 1177 (E.D.Va. 1977)("Because no violations of the Securities Act of 1933 and the Securities and Exchange Act of 1934 have been found, the Court is without jurisdiction to entertain the relief sought by the plaintiff."), *rev'd on other grounds*, 586 F.2d 1001 (4th Cir. 1978). On July 21, 1999, the District Court ruled, based upon the evidence produced at trial, that the joint venture interests were not securities. (App. 13a, 30a). As such, at that point, the District Court, had it chosen to do so, would have lacked subject matter jurisdiction to issue injunctions or other ancillary relief against the eight defendants that prevailed at the trial. *See, e.g., SEC v. American Realty Trust*, 429 F. Supp. at 1177. Likewise, because the District Court lacked jurisdiction to issue injunctive relief against the eight trial defendants, the District Court also lacked jurisdiction to issue injunctive relief against Kinlaw.

More specifically, unlike personal jurisdiction, which may be lacking as to some but not to all defendants, if subject matter jurisdiction is lacking, the court is powerless to proceed with the case as it relates to all defendants. By virtue of the Kinlaw Interlocutory Order, Kinlaw was still a party to the case at the time of trial. Thus, once the District Court determined that no "securities" were offered or sold, the court had no jurisdiction to issue

injunctive relief against any of the defendants, whether they be one of the eight trial defendants or Kinlaw.

Therefore, the Kinlaw Final Judgment is void, and the District Court committed reversible error when it failed to grant Kinlaw's Rule 60(b)(4) Motion to Vacate.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted.

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October 2001

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

U.S. Court of Appeals
FILED
May 14, 2001
Charles R. Fulbruge III Clerk

No. 00-10568

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

versus

KINLAW SECURITIES CORPORATION, et al.,

Defendants,

JOE D. KINLAW; STEPHEN R. PARKER; DYKE FERRELL,

Defendants-Appellants.

Appeals from the United States District Court
for the Northern District of Texas
(3:93-CV-2010-T)

Before POLITZ and BARKSDALE, Circuit Judges, and FALLON,[1] District Judge.

PER CURIAM:[2]

Having considered the briefs and pertinent parts of the record, and having heard the arguments of counsel, and essentially for the reasons stated the district court's order, we conclude the district court did not abuse its discretion in denying the Rule 60 motions at issue.

AFFIRMED

[1] District Judge of the Eastern District of Louisiana, sitting by designation.

[2] Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

U.S. District Clerk
Northern District of Texas
FILED
Apr. 10, 2000
Nancy Doherty, Clerk
By _____
Deputy

v.

No. 3:93-CV-2010-T

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

ENTERED ON DOCKET
Apr. 11, 2000
U.S. District Clerk's Office

ORDER DENYING MOTIONS TO VACATE FINAL JUDGMENT

Before the Court are motions to vacate final judgment pursuant to Federal Rule of Civil Procedure 60, filed by Defendants Joe D. Kinlaw, Dyke Ferrell, and Stephen R. Parker (Movants). The motions are opposed. After consideration, the Court believes the motions should be denied.

The facts of this case are complex and fully set out in the Court's Findings of Fact and Conclusions of Law, *SEC v. Kinlaw Sec. Corp.*, No. 3:93-CV-2010-T, slip op. (N.D. Tex. July 21, 1999). Therefore, an exhaustive recitation of the facts is not necessary. In short, Plaintiff Securities and Exchange Commission (SEC) filed this complaint in September 1993 against Kinlaw Oil Corporation, its president Joseph D. Kinlaw, Kinlaw Securities Corporation (an affiliated broker-dealer corporation), its vice-president of exploration Matthew Akin, and sixteen brokers employed by Kinlaw Securities Corporation. The SEC alleged that

Defendants, including Movants, participated in a fraudulent scheme to raise money for oil and gas ventures by telephone solicitation from sales offices in Dallas. The SEC claimed that Movants made materially false statements to investors in violation of section 17(a) of the Securities Act of 1933, Title 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, Title 15 U.S.C. §78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. The SEC also claimed that Movants violated the registration provisions in sections 5(a) and 5(c) of the Securities Act of 1933, Title 15 U.S.C. §§ 77e(a) and 77e(c).

Ten Defendants, including Movants, elected to settle with the SEC.[1] The remaining ten Defendants chose to proceed to trial. On August 6, 1999, the Court entered an Amended Final Judgment dismissing the SEC's complaint on the ground that the joint venture interests at issue did not constitute securities within the meaning of section 2(1) of the Securities Act of 1933, and section 3(a)(10) of the Securities and Exchange Act of 1934. The Amended Final Judgment also provided that the Final Judgments of Permanent Injunction and other Equitable Relief previously entered against Defendants who elected to settle with the SEC, including Movants, were valid and remained in full force and effect.

A motion under rule 60 will only be granted in "unique circumstances." *Pryor v. United States Postal Serv.*, 769 F.2d 281, 287 (5th Cir. 1985). Furthermore, the movant must show that he is entitled to relief under one of the specific grounds of Rule 60. *Edward H. Bohlin Co., Inc. v. Banning Co., Inc.*, 6 F.3d 350, 356 (5th Cir. 1993). Joe D. Kinlaw brings this motion pursuant to Rule 60(b)(4), (b)(5), and (b)(6). Ferrell and Parker bring their motions solely under section (b)(4) of Rule 60. Because Movants

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[1] The Court entered a Final Judgment of Permanent Injunction and Other Equitable Relief against Joe D. Kinlaw on July 27, 1995, against Parker on August 28, 1996, and against Ferrell on December 18, 1997—all pursuant to stipulated agreements.

rely on the same argument—which the Court rejects—to obtain relief under all of the Rule 60 grounds asserted, the Court need not address the hypothetical applicability of a specific Rule 60 ground to this situation.

Movants argue that since the Court dismissed the SEC's complaint against the Defendants who chose to proceed to trial for lack of subject matter jurisdiction, the Court had no subject matter jurisdiction to enter final judgments against Movants. This argument is specious, both in fact and in light of well-established, controlling law. The Court did not dismiss the SEC's complaint against the Defendants who chose to proceed to trial for lack of subject matter jurisdiction. The Court concluded that because the question of "whether the joint venture interests are securities reaches the merits of the case, the dismissal is with prejudice and not simply a dismissal for lack of subject matter jurisdiction." *SEC v. Kinlaw Sec. Corp.*, No. 3:93-CV-2010-T, slip op. at 20 n.4 (N.D. Tex. July 21, 1999) (citing *Bell v. Hood*, 327 U.S. 678, 682 (1946) & *Williamson v. Tucker*, 645 F.2d 404, 415 (5th Cir. 1981)). Movant seize upon the slight ambiguity in this sentence to argue that the Court somehow meant to dismiss the case both on the merits and for lack of subject matter jurisdiction. While perhaps the omission of the word "simply" in the above quoted sentence might have made the Court's intent clearer, the interpretation urged by Movants makes no sense whatsoever in light of the holdings of *Bell* and *Williamson*, and would in fact constitute reversible error.

"It is firmly established in our cases that the absence of a valid (as opposed to arguable) cause of action does not implicate subject matter jurisdiction, i.e., the court's statutory or constitutional power to adjudicate the case." *Steel Company v. Citizens for a Better Environment*, 523 U.S. 83, 89 (1998); *see generally* 13B Charles Alan Wright & Arthur R. Miller et al. *Federal Practice and Procedure* §3564 (2d ed. 1984). "Jurisdiction. . . is not

defeated. . . by the possibility that the averments might fail to state a cause of action on which petitioners could actually recover." *Steel Company*, 523 U.S. at 89. (quoting *Bell v. Hood*, 327 U.S. at 682); *Green v. Ferrell*, 664 F.2d 1292, 1294 (5th Cir. 1982) (citing *Bell v. Hood*) ("A plaintiff's failure to state a meritorious cause of action does not defeat subject matter jurisdiction.") A district court has jurisdiction to hear a case if the right of the plaintiff to recover under its complaint will be sustained if a federal law is given one construction and will be defeated if it is given another, unless the claim is facially insubstantial or frivolous. *Steel Company*, 523 U.S. at 89. "But if the plaintiff really makes a substantial claim under an act of Congress, there is jurisdiction whether the claim ultimately be held good or bad." *The Fair v. Kohler Die & Specialty Co.*, 228 U.S. 22, 25 (1913).

In *Williamson v. Tucker*, the United States Court of Appeals for the Fifth Circuit fully explained the applicability of this concept to a similar dispute as here—whether certain joint venture interests constituted securities within the definitions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In that case the Court held:

Where the defendant's challenge the court's jurisdiction is also a challenge to the existence of a federal cause of action, the proper course of action for the district court (assuming that the plaintiff's federal claim is not immaterial and made solely for the purpose of obtaining federal jurisdiction and is not insubstantial and frivolous) is to find that jurisdiction exists and deal with the objection as a direct attack on the merits of the plaintiff's case. The Supreme Court has made it clear that in that situation no purpose is served by indirectly arguing the merits in the context of federal jurisdiction. Judicial economy is best promoted when the existence of a federal right is directly reached and, where no claim is found to exist, the case is dismissed on the merits. . . . Therefore as a general rule a

claim cannot be dismissed for lack of subject matter jurisdiction because of the absence of a federal cause of action. The exceptions to this rule are narrowly drawn, and are intended to allow jurisdictional dismissals only in those cases where the federal claim is clearly immaterial or insubstantial.

645 F.2d at 415-416 (footnotes omitted). In *Williamson*, the Fifth Circuit held that the district court's dismissal of the case prior to trial was impermissible absent a finding that the plaintiff's claims were clearly frivolous and insubstantial. Movants do not argue that the SEC's claims were frivolous and insubstantial in this case.[2] Rather, they argue that the holdings in *Bell* and *Williamson* only apply to pretrial motions to dismiss. There is nothing in these cases that suggests such a limitation on their holding; moreover, this argument has been foreclosed by the Fifth Circuit in *Fragumar Corp. v. Dunlap*, 685 F.2d 127 (5th Cir. 1982).[3] In *Fragumar*, the question before the district court was also whether certain joint venture interests constituted securities under the definitions of the Securities Act of 1933 and the Securities Exchange Act of 1934. *Id.* at 128. The case proceeded to trial. At the close of the plaintiff's case, defendants moved to dismiss for lack of subject matter jurisdiction, or in the alternative, for a directed verdict. *Id.* The district judge dismissed the case for lack of subject matter jurisdiction, without ruling on the motion for a directed verdict because he believed he had no jurisdiction to do so. *Id.* The Fifth Circuit reversed, holding that "[w]hile it is correct that a

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[2] The Court would reject any such argument if it were made. See Order Denying Motions for Attorneys' Fees, *SEC v. Kinlaw Sec. Corp.*, No. 3:93-CV-2010-T, slip op. at 4 (N.D. Tex. March 21, 2000) (holding that the determination of whether the joint venture interests at issue fit the statutory definitions for securities was a "close question.")

[3] For reasons unknown to the Court, none of the parties reference the *Fragumar* case in their motion papers.

court without jurisdiction of a case cannot rule on its merits, it is incorrect to assume that the basis for determining jurisdiction is the record after trial and that failure to prove the claim results in loss of jurisdiction." *Id.* The court, citing *Williamson*, also held that the definition of the term security reached the merits of the case, and that the extensive pretrial proceedings and lengthy trial indicated that the issue was not so frivolous or insubstantial as to warrant dismissal for lack of subject matter jurisdiction. *Id.* at 129. Even more pertinent to the disposition of Movants' argument, is the Fifth Circuit's holding that a district court is not permitted to a dismiss such a case for lack of subject matter jurisdiction "after trial on the merits." *Id.*

The Court properly issued Findings of Fact and Conclusions of law dismissing the SEC's complaint against the non-settling Defendants on the merits. If the Court had dismissed the SEC's complaint against the non-settling Defendants after trial for lack of subject matter jurisdiction, it would have committed reversible error, just as did the district judge in *Fragumar*. *Id.* Since the issue of whether the joint venture interests sold by Defendants in this case reached the merits of the SEC's case, and the SEC's claims were not frivolous or wholly insubstantial, the Court had subject matter jurisdiction to enter final judgments against Movants.

It is therefore **ORDERED** that the Motion to Vacate Final Judgment filed by Defendant Dyke Ferrell on January 25, 2000 is **denied**.

It is **FURTHER ORDERED** that the Motion to Vacate Final Judgment, filed by Defendant Stephen R. Parker on January 25, 2000, is **denied**.

It is **FURTHER ORDERED** that motion to vacate final judgment, filed by Defendant Joe D. Kinlaw on February 2, 2000, is **denied**.

Signed this 10th day of April, 2000.

/s/

Robert B. Maloney
U.S. District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

U.S. District Clerk
Northern District of Texas
FILED
Aug. 6, 1999
Nancy Doherty, Clerk
By _____
Deputy

v.

No. 3:93-CV-2010-T

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

ENTERED ON DOCKET
Aug. 6, 1999
U.S. District Clerk's Office

AMENDED FINAL JUDGMENT

This action came before the Court, Honorable Robert B. Maloney, presiding on a non-jury trial concluded March 30, 1998, and the issues having been duly considered and a decision having been rendered:

It is **ORDERED** and **ADJUDGED** that the Securities and Exchange Commission's claims against Defendants Matthew C. Akin, Matthew Fleeger, Reed Cagle, Randall Rust, Gerald M. Hill, Wilbur Westmoreland, Clifton Zimmerman, Randol Bradshaw, and Steve Harris are **dismissed with prejudice.**

It is **FURTHER ORDERED** and **ADJUDGED** that the Securities and Exchange Commission's claims against Defendant Gordon T. Gill are **dismissed with prejudice.**

It is **FURTHER ORDERED** and **ADJUDGED** that the Final Judgments entered against Defendants Steven R. Parker, Bret L. Boteler, Dyke Ferrell, Cecil B. Glass, James B. Boswell, Roger D. Byrd, and Paul L. Nieto are in full

force and effect and shall be enforced according to the terms of the Consent Judgments entered into by Parker, Boteler, Ferrell, Glass, Boswell, Byrd, and Nieto.

IT IS **FURTHER ORDERED** and **ADJUDGED** that the Order of Permanent Injunction and Other Equitable Relief entered against Defendants Joe D. Kinlaw, Kinlaw Oil Corporation, and Kinlaw Securities Corporation on July 25, 1995, shall be enforced according to the terms of the Order of Permanent Injunction and the Consents and Undertakings entered into by Joe D. Kinlaw, Kinlaw Oil Corporation, Kinlaw Securities Corporation, and the Securities and Exchange Commission.

It is **FURTHER ORDERED** and **ADJUDGED** that all relief not granted herein is **denied.**

Signed this 5th day of August, 1999.

/s/

Robert B. Maloney
U.S. District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

FILED
July 21, 1999
Nancy Doherty,
Clerk
By _____
Deputy

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

No. 3:93-CV-2010-T

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

ENTERED ON DOCKET
July 22, 1999
U.S. District Clerk's Office

ORDER CONCERNING AMENDED FINAL JUDGMENT

The Court has issued its final judgment in this action. However, the Court recognizes that, pursuant to agreements between the SEC and some of the original defendants, other judgments have previously been entered. The Court is unclear whether the parties intended the earlier judgments to be final as to those parties, or whether they were to be incorporated into the Court's final judgment.

As a judgment that fails to dispose of all the parties might be deemed defective and unappealable, counsel should suggest to the Court how such a defect may be cured by submitting a motion to alter or amend the final judgment. Counsel should submit as an exhibit to the motion a proposed amended final judgment that disposes of all parties. The Court realizes that a party may disagree with the Court's disposition on the merits; however, it is theintention of the Court to enter a final, appealable judgment as to all claims and all parties.

It is therefore **ORDERED** that the parties are to submit a proposed amended final judgment no later than **August 2, 1999.**

Signed this 21st day of July, 1999.

/s/

Robert B. Maloney
U.S. District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

U.S. District Clerk
Northern District of Texas
FILED
July 21, 1999
Nancy Doherty, Clerk
By _____
Deputy

v.

No. 3:93-CV-2010-T

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

ENTERED ON DOCKET
July 22, 1999
U.S. District Clerk's Office

FINAL JUDGMENT

This action came before the Court, Honorable Robert B. Maloney, presiding on a non-jury trial concluded March 30, 1998, and the issues having been duly considered and a decision having been rendered:

It is **ORDERED** and **ADJUDGED** that the SEC's claims against Defendants Matthew C. Akin, Matthew Fleeger, Reed Cagle, Randall Rust, Gerald M. Hill, Wilbur Westmoreland, Clifton Zimmerman, Randol Bradshaw, and Steve Harris are **dismissed with prejudice.**

It is **FURTHER ORDERED** and **ADJUDGED** that all relief not granted herein is **denied.**

Signed this 21st day of July, 1999.

/s/

Robert B. Maloney
U.S. District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

FILED
July 21, 1999
Nancy Doherty, Clerk
By _____
Deputy

v.

No. 3:93-CV-2010-T

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

ENTERED ON DOCKET
July 22, 1999
U.S. District Clerk's Office

COURT'S FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for trial before the Court beginning February 23, 1998, and concluding on March 30, 1998. Plaintiff United States Securities and Exchange Commission (SEC) appeared through its counsel, and Defendants Matthew C. Akin, Matthew Fleeger, Reed Cagle, Randall Rust, Gerald M. Hill, Wilbur Westmoreland, Clifton Zimmerman, Randol Bradshaw, and Steve Harris appeared by and through their respective counsel.

The SEC contends that Defendants,[1] with the exception of Akin, offered and sold securities and, in connection

[1] On July 27, 1995, the Court, pursuant to consent decrees filed on July 20, 1995, entered an order of permanent injunction and other equitable relief against Kinlaw Oil Corporation, Kinlaw Securities Corporation, and Joe D. Kinlaw. Accordingly, the only claims asserted by the SEC are against the individual broker defendants and Akin.

therewith, made false, misleading, or incomplete statements to investors in violation of the registration and antifraud provisions of the federal securities laws. The SEC claims that Defendant Akin violated the federal securities laws by preparing false and misleading maps that were sent to potential investors.

The SEC seeks an order enjoining Defendants from further violations of the securities laws; disgorgement of commissions, salaries, and bonuses; prejudgment interest; and civil penalties.

Defendants argue, first, that the joint venture interests they sold are not securities, and that the SEC complaint therefore has failed to state a claim. Further, Defendants argue that even if the joint venture interests are securities, they did not violate the federal securities laws.

After considering the pleadings, evidence, and argument of counsel, the Court makes its findings of fact and conclusions of law as follows:

FINDINGS OF FACT

1. Plaintiff is the Securities and Exchange Commission.

2. Defendants Matthew Fleeger, Reed Cagle, Randall Rust, Gerald Hill, Wilbur Westmoreland, Clifton Zimmerman, Randol Bradshaw, and Steve Harris are brokers employed by Kinlaw Security Corporation (KSC).

3. KSC was incorporated under the laws of the State of Texas in 1986 and was, at all times relevant to the allegations in the SEC's Complaint, duly incorporated and in good standing under the laws of the State of Texas. KSC at all times relevant to the SEC's Complaint, was registered as a broker/dealer with the SEC and the National Association of Securities Dealers, Inc.

4. Defendant Matthew C. Akin was hired by Kinlaw Oil Corporation (KOC) as a landman on February 24, 1988. KOC was incorporated under the laws of the State of Texas and at all times relevant to the allegations of the SEC's Complaint, was duly incorporated under the laws of the State of Texas.

5. Akin's position as Vice-President of Exploration and Development required him to identify properties for potential exploration and development, to gather information from numerous sources, to pass on information he learned to Joe D. Kinlaw, owner of KOC and KSC, and to supervise field personnel. Once Kinlaw approved the acquisition of a particular lease, Akin was responsible for contracting and overseeing drilling and completion, ensuring compliance with safety rules, reporting on drilling and completion to the Texas Railroad Commission, and reporting on progress to Kinlaw.

6. In 1989, Akin learned through investigation that Oryx, a leading Texas independent exploration company, had encountered substantial production through horizontal drilling in the Pearsall Field of South Texas. Akin prepared maps of the field, and those maps were given to third parties who used the information on Akin's maps to produce other maps which were included in documents distributed by the KSC brokers.

7. During the period between January 1990, and July 31, 1993, KOC sponsored (a) 36 separate general partnerships in the form of joint ventures to conduct oil and gas drilling operations in the Austin Chalk Formation in the Pearsall Field in South Texas utilizing the then newly developed horizontal drilling techniques, and (b) 14 separate general partnerships in the form of joint ventures to conduct oil and gas drilling operations in waters off the coast of Louisiana in the Bay Marchand region.

8. For each of the joint ventures, KOC prepared a summary package called Preview.

9. Interests in the joint ventures were offered and sold by KSC and its brokers. Typically, the brokers made "cold calls" to potential investors. If the potential investor appeared interested, he would be sent a Preview and receive a subsequent call from the broker. If the investor was so inclined, he would then send a check to KSC and receive a Confidential Information Memorandum (CIM) package.

10. The CIM package contained information about the particular joint venture, a Joint Venture Agreement, and the Subscription or Application Agreement, a statement to be executed concerning the investor's financial status and business acumen.

11. With few exceptions, each venturer received a Preview with respect to the particular joint venture before becoming a joint venturer.

12. With respect to each joint venture, each venturer executed the Subscription or Application Agreement contained in the Preview.

13. The Joint Venture Agreement for each joint venture provided that KOC would be the managing venturer, but it provided the joint venturers with significant rights and authority in the joint venture.

14. Each joint venturer was provided with the rights and authority of general partners to manage the joint venture.

15. For each joint venture, the venturers were provided with the right to vote on virtually all aspects of the joint venture operations, and in each joint venture, they exercised those voting rights to manage the joint venture.

16. Each joint venture was separate and distinct, financially, economically, and otherwise from each other joint venture.

17. Each joint venture owned its own assets, conducted its own operations, maintained separate books

and records, and owned interests in a well or wells on acreage separate from any other joint venture.

18. A venturer in one joint venture acquired no interest in another joint venture and acquired no profit or loss potential with respect to any joint venture other than the one in which he or she participated.

19. Income from one joint venture was distributed only to the venturers of that particular joint venture.

20. Losses incurred by one joint venture were not allocated to any other joint venture.

21. With few exceptions, joint venturers who requested the names and addresses of their joint venture partners after becoming partners were provided to them by KOC.

22. On the cover page of the Application Agreement contained in the CIM's, originals of which were executed by all venturers in each joint venture, there appeared a statement, prominently displayed, stating:

> NOTICE: Participants in this Joint Venture are provided extensive and significant management powers. Participants are and will be expected to exercise such powers and are prohibited from relying on the Managing Venturer for the success or profitability of the Venture.

23. On the first page of the Questionnaire contained in the CIM, which each joint venturer was required to execute and return to KOC before admission into the joint venture, there is the following representation by the venturer to KOC:

> The undersigned understands that participation in the Joint Venture is not intended or considered by the Managing Venturer to be "securities," as that term is used in state and federal securities regulations; that participation in the Joint Venture is an active business venture requiring the

exercise of experience and knowledge in business affairs while participating as a Venturer; and that participation in this Venture is not a passive investment or activity.

As a condition to participating as a Venturer, and knowing that you [KOC] will rely upon the statements made herein in determining the suitability of the undersigned as a Venturer in the Joint Venture, the undersigned represents and warrants to you that ***

_____ The undersigned warrants and represents that he or she possesses extensive experience and knowledge in business affairs such that he is capable of intelligently exercising his or her management powers s a Joint Venturer.

_____ The undersigned warrants and represents that the undersigned is not relying on the unique entrepreneurial or managerial ability of KOC for the success of the Venture, and that his or her experience and knowledge in business affairs enabling the undersigned to replace KOC as Managing Venturer and Operator and otherwise exercise meaningful joint venture powers. The undersigned understands and stipulates for all purpose that other Drillers, Operators, Joint Venture Managers, and related oil and gas experts are readily available in Texas which are competent to perform KOC's functions.

24. With few exceptions, each venturer in each respective joint venture either checked or initialed the two paragraphs on page one of the Questionnaire.

25. Evidence was presented concerning several of the venturers and their backgrounds. The witnesses were investors chosen and presented by the SEC as typical of most, if not all, the joint venturers.

26. Don Bauder, 61 years old, obtained a bachelor of science degree in mechanical engineering and did graduate work in mathematics. He was an engineer (retired) and a former Distinguished Member of the technical staff at Sandia National Laboratories who worked in intelligence and arms control. Bauder had a net worth before his first participation with KOC in excess of $1 million dollars and had an annual income in excess of $100,000. He testified that he never attempted to learn the names of his partners, knew he had partnership rights, and did not attempt to exercise any of his partnership rights.

27. Richard Bellezza was 41 years old at the time he participated with Kinlaw in a joint venture. He had a degree in journalism; was treasurer, general manager, and part owner of his own company; and was head of corporate finance and personnel in charge of the operation of a company with $20 million in annual sales. Bellezza had a net worth at the time of his first participation in excess of $250,000, and an annual income of $50,000.

28. Gerry Burgess, 51 years old, received a bachelor of science degree in mathematics and a master's degree in computer science and in business administration. He was an IBM executive; was formerly CEO of PERRICH, a subsidiary of Perot Systems, a $900 million company; and had a net worth of more than $1 million and annual income in excess of $175,000. Before investing in KOC joint ventures, Burgess had numerous other investments.

29. Theodore Burkholder, 85, was a retired doctor. Like the other venturers, Burkholder, before participating in a joint venture, warranted and represented to Kinlaw that, among other things, he possessed extensive experience and knowledge in business affairs such that he was capable of intelligently exercising his management powers as a joint venturer.

30. George Dawson, 45, received a bachelor of science degree in aviation engineering technology and a

master's degree in business administration before investing with Kinlaw. He was employed as an aerospace engineer for the NASA Space Shuttle Program; was married to a financial advisor who was an economics major and an MBA; had a net worth in excess of $1 million; and, in addition to his aerospace employment, earned up to $20,000 per month by raising venture capital.

31. Phillip Carter had a net worth of approximately $300,00 and an annual income of approximately $90,000. Like the other venturers, he represented to Kinlaw that he possessed extensive experience and knowledge in business affairs such that he was capable of intelligently exercising his management powers as a joint venturer.

32. Phillip Gans, 43, had a bachelor of arts degree and a law degree from Yale University. He is a practicing attorney with oil and gas experience and oil and gas investment experience. Gans received full recision of his entire investment.

33. Roland Haitz, 54, received his master's degree and his doctorate in physics, and was a research and development project manager for Hewlett-Packard. He invested in other oil and gas ventures, including joint ventures and direct participation programs, during the time he was investing with KOC. Haitz had a net worth in excess of $1 million; visited the field on three different occasions; did extensive research on horizontal drilling; and had heard of horizontal drilling as new technology with lower risks before investing with KOC. Haitz exercised his joint venture powers and rights by voting on each of the propositions presented to the venturers in the joint ventures in which he participated.

34. Darryl Hansen, 47, was a retired marine pipefitter. Before investing in Kinlaw, Hansen traded in penny stocks that had a high degree of risk. Hansen represented that he had a net worth of between $100,000 and $500,000, and that he possessed extensive experience and knowledge in business affairs such that he was capable of

intelligently exercising his management powers as a joint venturer.

35. Earl Iles, 71, was a retired real estate entrepreneur, had other oil and gas experience (including joint ventures), and had extensive experience in real estate investing.

36. Kim Johnson, 35, had a net worth of approximately $350,000 and an annual income of $50,000. He had participated in an oil and gas drilling venture before investing in KOC. That venture went bankrupt.

37. Richard Kerns, 42, received a bachelor of science degree and partially completed a master's program. He was a manufacturer and owner of his own company. He participated in options trading before investing with Kinlaw, and had a liquid net worth of approximately $300,000 at the time he participated.

38. Ronald Kilbourn, 48, received a bachelor of science degree and a master's degree in education. He had a net worth in excess of $400,000 and had a salary of approximately $70,000. He testified that when he requested a list of the names, addresses, and telephone numbers of his partners, he was provided with that list.

39. William Kuehn, 59, with a degree in history and education, was a self-employed business consultant with experience in oil and gas investing. He had been the president of a company that, at the time he left, had gross sales of $48 to $50 million. Kuehn had a net worth in excess of $1 million. Before investing in KOC joint ventures, Kuehn invested in stocks and other investment vehicles. Kuehn exercised his joint venture powers and rights by voting on each of the propositions presented to venturers in the joint ventures in which he participated.

40. Richard Martucci, 40, a marine pilot (shipping) had a net worth of approximately $200,000 and had opened his own business.

41. Ken Massey, 64, was a retired general contractor. He owned his own business, had an annual income of over $200,000, and had a net worth in excess of $1 million.

42. Charles Miller, 76, was a retired U.S. Customs Officer. Like the other venturers, he represented to KOC and KSC that he possessed extensive experience and knowledge in business affairs such that he was capable of intelligently exercising his management powers as a joint venturer.

43. Manuel Moya, 60, was educated with a bachelor of science degree in civil engineering. He is the executive vice president of construction for Hunt Building Corporation, and had a net worth in excess of $1 million. Moya stated that he was well aware that he could call professionals and ask for their advice in managing the venture and felt that he had the expertise to do so.

44. Paul Nunn received his bachelor of science degree in chemical engineering and took graduate courses He was a retired chemical engineer, having spent 32 years working at Exxon. Nunn had managed personal investments in excess of $1,800,000 and had attended investment seminars. He was learned in investments and economics and had a net worth in excess of $1 million.

45. Robert Stroud was a retired vice president of a company with $35 million in annual sales. He was an electrical engineer; was an owner and treasurer in his own company; and had a net worth in excess of $2 million.

46. Edward West, 37, received his bachelor of arts degree from Princeton and an MBA from Harvard. Before investing in KOC, he was the general manager of a company and had full profit and loss responsibility for a $150 million operating unit. He was the president of his own company; had a net worth in excess of $1 million; and had an annual salary of $275,000. West had previously prepared offering documents and sold stock in his own company to investors.

47. Andrew Sellers received a bachelor's degree in aerospace engineering and a master's degree in mechanical engineering. Sellars invested in Texakoma Oil Corporation and horizontal drilling in the Pearsall Field at the same time he was investing with KOC.

48. Norman Magg was a financial services and investment advisor, farm consultant, and owner of his own feed business. He represented to Kinlaw that he possessed extensive experience and knowledge in business affairs such that he was capable of intelligently exercising his management powers as a joint venturer.

49. The Court finds that the joint venturers invested money in a common enterprise, that of each joint venture.

50. The Court finds that the joint venturers did not invest money on an expectation of profits to be derived solely from the efforts of individuals other than the joint venturers. Each joint venture agreement gave the venturers rights that were real and not illusory. These rights included the right to vote on all important decisions in the joint venture, to amend the joint venture agreement, to call a meeting, to remove the managing venturer, and all other rights provided to general partners in Texas. The joint venturers retained control over the investment by virtue of their partnership rights, whether or not they actually exercised that power. Some of the joint venturers in fact exercised their rights.

51. Some venturers had previous experience in joint ventures and some had previous oil and gas experience. The venturers had the business experience that would allow them to hire a managing venturer and to delegate the duties of operating the wells.

52. Each of the venturers had the business and financial acumen, capability, and authority to exercise the joint venture powers provided in the Joint Venture Agreement.

Conclusions of Law

1. This is an action under the securities registration provisions of Section 5(a) and 5(c) of the Securities Act of 1933 (Securities Act), as amended 15 U.S.C. §77e(a) and 77e(c); the antifraud provisions of Section 17(a) of the Securities Act, 15 U.S.C. §77q(a); Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), as amended 15 U.S.C. §78j(b); and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5.

2. The Court has jurisdiction over this action under Section 22(a) of the Securities Act and Section 27 of the Exchange Act.

3. The purpose of the Securities Act "is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions." *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). In this regard, Sections 5(a) and 5(c) of the Securities Act provide, in relevant part, that it shall be unlawful to sell or offer to sell, directly or indirectly, any security using the mails or other means, or instrumentalities of interstate commerce unless a registration statement, including a prospectus, has been filed and is in effect for the security, or unless the security is exempt from registration.

4. Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a); Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b); and Rule 10b-5, 17 C.F.R. § 240, prohibit fraud in the offer or sale, or in connection with the purchase or sale, of securities. *See Huddleston v. Herman & McLean* 640 F.2d 534, 543 (5th Cir. 1981), *rev'd on other grounds*, 459 U.S. 375, 390, (1983).

5. Section 17(a) of the Securities Act provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication

in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

6. Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person. .. [t]o use or employ, in connection with the purchase or sale of any security. .. any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

7. Pursuant to its rule-making authority under this section, the Commission promulgated Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, artifice to defraud,
>
> (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order

to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

8. The above statutes and regulations apply only to "securities" as that term is defined. Section 2(1) of the Securities Act and Section 3(a)(10) of the Exchange Act define the term "security" to include an investment contract. The term investment contract has been defined to include a contract, transaction, or scheme whereby a person (1) invests money, (2) in a common enterprise, and (3) is led to expect profits solely from the efforts of the promoter or a third party. *See SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946); *United Housing Found. Inc. v. Forman*, 421 U.S. 837, 851-52 (1975); *Youmans v. Simon*, 791 F.2d 341 (5th Cir. 1986). This test is to be applied in light of the "substance and economic realities of the transaction-rather than names that may have been employed." *United Housing Found. Inc.*, 421 U.S. at 851-52; *accord, Williamson v. Tucker*, 645 F.2d 404 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981). Thus, a "scheme which sells investments to inexperienced and unknowledgeable members of the general public cannot escape the reach of the securities laws merely by labelling itself a general partnership or joint venture." *Id.*, 645 F.2d at 423.

9. The KOC investments offered and sold by Defendants meet the first two prongs of the *Howey* test. That is,

the investment involves "an investment of money" in a "common enterprise."[2]

10. The Court concludes, however, that based on the above findings, the third prong of the *Howey* test, that the investors were led to expect profits derived from the efforts of others, was not met.

11. General partnership interests are not included among the enumerated types of securities under the definition of security as contained in either the Securities Act or the Exchange Act. Joint ventures are subject to the same analysis as general partnerships. *See Youmans*, 791 F.2d at 346 n.2. There is a strong presumption that a general partnership interest is not a security. *See id.* at 346. The party seeking to overcome this strong presumption, in this case the SEC, bears a heavy burden of proof. See id.

12. The controlling case on the third prong in *Howey* in the Fifth Circuit is *Williamson*, 645 F.2d at 422-24. *Williamson* established exceptions to the usual rule that a general partnership interest is not a security. A general partnership or joint venture interest may be a security if, "in spite of the partnership form which the investment took, [the investor] was so dependent on the promoter or on a third party that he was in fact unable to exercise meaningful partnership powers." *Id.* at 424.

13. The court in *Williamson* gave three examples where a general partnership or joint venture interest may be deemed a security:

(1) the agreement among the parties leaves so little power in the hands of the partner or venturer that

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[2] A common enterprise is defined as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." *See SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478-79 (5th Cir. 1974); *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).

the arrangement in fact distributes power as would a limited partnership; or

(2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or

(3) The partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Id. at 424. The court also noted that these three examples are not exclusive; other factors may also be significant. *See id.*

14. Here, the joint ventures were structured as general partnerships and the Joint Venture Agreements left considerable rights and obligations in the hands of the joint venturers, including all of the rights, obligations and liabilities under the Texas Uniform Partnership Act. The SEC failed to present sufficient evidence to sustain its heavy burden of establishing that the joint venture interests were securities under *Williamson*.

15. The SEC has not shown that the first example under *Williamson* is present. The argument that power was dispersed so much so that the joint venturers could not exercise their rights is belied by the reality of what occurred. For example, by an order dated November 27, 1995, this Court denied a request by the SEC to vacate a vote of the joint venturers to replace KOC as operator of the horizontal and offshore wells. The SEC requested that a new election be held in which the SEC's nominee could be placed on the ballot. The joint venturers have, in the past, actually exercised their rights. Additionally, while the SEC stated that each joint venture consisted of numerous joint venturers, it presented very little evidence regarding the specific number of joint venturers in each joint venture

and the disbursement of voting power within each joint venture.

16. The Court also determines that the SEC failed to present sufficient evidence that the joint venturers were so inexperienced and unknowledgeable in business affairs that they were incapable of intelligently exercising the partnership or venture powers. As noted in the findings, the investors represented that they possessed the experience and knowledge in business affairs so that they could exercise the powers given them. More importantly, many of the investors who testified were experienced business people and investors, most were highly educated, and some had experience in oil and gas. The evidence presented does not indicate that the second factor in Williamson was met.[3]

17. Finally, the SEC presented no evidence that KOC's ability was unique such that KOC could not be replaced as the managing venturer.

---

[3] The Court is aware of dicta in *Long v. Schultz Cattle Co.*, 881 F.2d 129, 134 n.3 (5th Cir. 1989), that the business experience required is experience in the underlying business of the venture. However, in every case in this circuit, other than *Long*, the test has been experience in "business affairs." *See Williamson*, 645 F.2d at 424; *Sparks v. Baxter*, 854 F.2d 110, 114 (5th Cir. 1988); *Youmans*, 791 F.2d at 346. In any event, the experience required here was that which would allow the joint venturer to manage and make business decisions, not to drill a well, drive a truck, or perform other tasks that would be delegated. As the court stated in *Williamson*, "We must emphasize, however, that a reliance on others does not exist merely because the partners have chosen to hire another party to manage their investment. The delegation of rights and duties-standing alone-does not give rise to the sort of dependence on others which underlies the third prong of the *Howey* test." *Williamson*, 645 F.2d at 423.

The strict reading of *Long* which the SEC proposes would mean that an oil field worker with little business and investing experience would not fall under the second *Williamson* example, while a multi-million dollar investor with substantial business experience in a wide array of investments would fall under *Williamson* because he had never drilled an oil well. Such a reading would not be consistent with *Williamson* or *Howey*.

18. In light of the evidence presented and based on the findings stated above, the joint venturers had rights and powers that gave them the opportunity to protect themselves from the manager. Accordingly, the SEC did not overcome its "difficult burden" of establishing that the joint venture interests are securities. *See Williamson*, 645 F.2d at 424.

19. Because the joint venture interests are not securities, the SEC claims must be dismissed.[4]

Reasons for Judgment

Based on the finds of fact and conclusions of law, the Court concludes that the joint venture interests are not securities.

If the Court were to determine that these interests were securities, it would have to conclude, based on a smattering of evidence, that they were securities for some of the investors who possessed sufficient business experience to manage the joint venture, but chose not to exercise that power, and were not securities for others. If the Court so concluded, it would not only be contrary to the law, but contrary to normal business practices.

Signed this 21st day of July, 1999.

/s/
Robert B. Maloney
U.S. District Judge

[4] Because whether the joint venture interests are securities reaches the merits of the case, the dismissal is with prejudice and not simply a dismissal for lack of subject matter jurisdiction. *See Williamson*, 645 F.2d at 415 (quoting *Bell v. Hood*, 327 U.S. 678, 682 (1945)).

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

KINLAW SECURITIES CORPORATION, KINLAW OIL CORPORATION, and JOE D. KINLAW, *et al.*,

Defendants and Counter-Plaintiffs,

CIVIL ACTION NO. 3:93-CV-2010-T

U.S. District Court
Northern District of Texas
FILED
July 27, 1995
Nancy Doherty, Clerk
By _____
Deputy

v.

JAMES E. SIMS,

Counter-Defendants.

ORDER OF PERMANENT INJUNCTION AND OTHER EQUITABLE RELIEF AGAINST JOE D. KINLAW, KINLAW OIL CORPORATION AND KINLAW SECURITIES CORPORATION

Plaintiff, Securities and Exchange Commission ("Commission"), having filed its Complaint and its First Amended Complaint in this matter, and defendants Joe D. Kinlaw ("Kinlaw"), Kinlaw Oil Corporation ("KOC") and Kinlaw Securities Corporation ("Kinlaw Securities"), in each of their Consent and Undertaking ("Consent"), having admitted service of the Summons and Complaint and

First Amended Complaint in this matter; having admitted, solely for purposes of this action, the jurisdiction of this Court over them and over the subject matter of this action; having waived the entry of findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure; having entered into their Consents voluntarily, and no threats, promises of immunity, or assurances have been made by the Commission, or any of its members, officers, agents or representatives to induce them to enter into their Consents; and having consented, without admitting or denying any of the allegations in the Commission's Complaint and First Amended Complaint, except as to jurisdiction as set forth above, to entry without further notice of this Order of Permanent Injunction and Other Equitable Relief ("Order"), enjoining Kinlaw, KOC and Kinlaw Securities from engaging in transactions, acts, practices and courses of business which constitute and would constitute violations of Section 10(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], and violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, as amended ("Securities Act") [15 U.S.C. §§ 77e(a), 77e(c) and 77q(a)], and, as to Kinlaw Securities, violations of Section 15(c)(1) of the Exchange Act [15 U.S.C. §78o(c)(1)] and Rule 15c1-2 thereunder [17 C.F.R. § 240.15c1-2], and, it further appearing that this Court has jurisdiction over Kinlaw, KOC and Kinlaw Securities and the subject matter of this action; it appearing that no further notice of hearing for the entry of this Order need be given; and the Court being fully advised in the premises:

I.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that defendants Kinlaw, KOC and Kinlaw Securities, and their respective officers, agents, servants, employees, attorneys-in-fact and all persons in active concert or participation with them, who receive actual notice

of this Order by personal service or otherwise, and each of them, be and hereby are permanently restrained and enjoined, directly or indirectly, in connection with the purchase or sale of securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, from making use of any means or instrumentalities of interstate commerce or of the mails, or of any facility of any national securities exchange:

(a) to employ any device, scheme or artifice to defraud;

(b) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

II.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Kinlaw, KOC and Kinlaw Securities, and their respective officers, agents, servants, employees, attorneys-in-fact and all persons in active concert or participation with them, who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently restrained and enjoined, in the offer or sale of securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, from making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, directly or indirectly:

(a) to employ any device, scheme, or artifice to defraud;

(b) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any purchaser.

III.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Kinlaw, KOC and Kinlaw Securities, and their respective officers, agents, servants, employees, attorneys-in-fact, and all persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently restrained and enjoined from, directly or indirectly:

(a) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell any securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, through the use or medium of any prospectus or otherwise, unless and until a registration statement is in effect with the Commission as to such securities;

(b) carrying securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, or causing them to be carried through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or delivery after sale, unless and until a registration statement is

in effect with the Commission as to such securities; or

(c) making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy, through the use of medium of any prospectus or otherwise, securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, unless a registration statement has been filed with the Commission as to such securities, or while a registration statement filed with the Commission as to such securities is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding of examination under Section 8 of the Securities Act of 1933, as amended [15 U.S.C. § 77h]; provided, however, that nothing in this Part III shall apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended [15 U.S.C. § 77e].

IV.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Kinlaw Securities, and its officers, agents, servants, employees, attorneys-in-fact, and all persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently restrained and enjoined, directly or indirectly, by use of the mails or any means or instrumentalities of interstate commerce, from effecting transactions in, inducing or attempting to induce the purchase or sale of securities in the form of investment contracts involving interests in oil and gas drilling ventures, or any other security, otherwise than on a national securities exchange,

by means of any manipulative, deceptive or fraudulent device and contrivance, including:

(a) making any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading; or

(b) employing any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

V.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Kinlaw, KOC, Kinlaw Securities shall pay disgorgement, plus prejudgment interest, in an amount to be determined by agreement of the parties, or by the Court. Defendants Kinlaw, KOC and Kinlaw Securities shall provide to the Commission, within thirty (30) days of entry of this Order, the documents and other information necessary to determine the appropriate amount of disgorgement. In the event the parties are unable to agree as to the disgorgement amount, the matter, upon application, will be set for a hearing so that the Court can determine the disgorgement amount, and any such application shall be referred to a Magistrate, in accordance with the consent of the parties, for expedited resolution. Defendants Kinlaw, KOC and Kinlaw Securities may not, by way of defense to such application, challenge the validity of their respective Consents or this Order, or assert that disgorgement, and prejudgment interest thereon, should not be ordered by the Court for violations of the federal securities laws alleged in the Commission's Complaint and First Amended Complaint.

VI.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Kinlaw, KOC and Kinlaw Securities shall pay a civil penalty, pursuant to the provisions of Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. §78u(d)]. The amount of penalty shall be determined by agreement of the parties, or by the Court. In the event the parties are unable to agree as to the penalty amount, the matter, upon application, will be set for a hearing so that the Court can determine the amount of penalty, and any such application shall be referred to a Magistrate, in accordance with the consent of the parties, for expedited resolution. Defendants Kinlaw, KOC and Kinlaw Securities may not, by way of defense to such application, challenge the validity of their respective Consents or this Order, or assert that a civil penalty should not be ordered by the Court for violations of the federal securities laws alleged in the Commission's Complaint and First Amended Complaint.

VII.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Kinlaw, KOC and Kinlaw Securities shall each provide to the Commission, within thirty (30) days of entry of this Order, a sworn accounting of their respective financial condition and of whatever monies and properties they received, either directly or indirectly, as a result of the activities alleged in Plaintiff's Complaint and First Amended Complaint, including monies raised from investors through the offer and sale of oil and gas interests described in the Complaint and First Amended Complaint, and monies or other assets they received, either directly or indirectly, from Kinlaw, KOC and Kinlaw Securities, or any joint venture for which KOC served as managing venturer, and, in the event the parties cannot agree within sixty (60) days of entry of this Order as to the disgorgement and penalty amounts which defendants Kinlaw,

KOC and Kinlaw Securities shall pay, defendants Kinlaw, KOC and Kinlaw Securities shall file the foregoing sworn accountings with this Court within ten (10) days thereafter or within seventy (70) days of entry of this Order.

VIII.

IT IS FURTHER ORDERED that the Consents of defendants Kinlaw, KOC and Kinlaw Securities filed herein be, and the same are hereby, incorporated in this Order with the same force and effect as if fully set forth herein, and defendants Kinlaw, KOC and Kinlaw Securities shall comply fully with their undertakings set forth in each of their Consents.

IX.

IT IS FURTHER ORDERED that this Court shall retain jurisdiction of this action for all purposes, including for purposes of entertaining any suitable application or motion by the Commission for additional relief within the jurisdiction of this Court, including but not limited to the relief requested by the Commission in its Complaint and First Amended Complaint in this action.

X.

IT IS FURTHER ORDERED that this Order of Permanent Injunction and Other Equitable Relief may be served upon defendants Kinlaw, KOC and Kinlaw Securities in person or by mail either by the United States Marshal, the Clerk of the Court, or any member of the staff of the Securities and Exchange Commission.

DATED and SIGNED on this 27th day of July, 1995.

/s/
ROBERT B. MALONEY
UNITED STATES DISTRICT
JUDGE

AGREED AS TO FORM AND SUBSTANCE

/s/
JOE D. KINLAW, individually and on behalf of
Kinlaw Oil Corporation and Kinlaw Securities
Corporation

APPROVED AS TO FORM

/s/
Joel Held, Esq.
Hill, Held, Metzger, Lofgren & Peele, L.L.P.
One Turtle Creek Village
3878 Oak Lawn Avenue, Fourth Floor
Dallas, TX 75219-4498
(214) 523-3700
Attorney for Joe D. Kinlaw, Kinlaw Oil
Corporation and Kinlaw Securities Corporation

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 00-10568

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee

v.

KINLAW SECURITIES CORPORATION, ET AL.,
Defendants.

U.S. Court of Appeals
FILED
July 9, 2001
Charles R. Fulbruge III, Clerk

JOE D KINLAW; STEPHEN R PARKER; DYKE FERRELL

Defendants-Appellants

Appeal from the United States District Court for the Northern District of Texas, Dallas

ON PETITIONS FOR REHEARING

Before POLITZ and BARKSDALE, Circuit Judges, and FALLON,* District Judge.

PER CURIAM:

IT IS ORDERED that the petitions for rehearing are **DENIED.**

ENTERED FOR THE COURT:

/s/

United States Circuit Judge

*District Judge of the Eastern District of Louisiana, sitting by designation.

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

KINLAW SECURITIES CORPORATION, et al.,

Defendants.

No. 3:93-CV-2010-T

U.S. District Clerk
Northern District of Texas
FILED
Feb. 2, 2000

Nancy Doherty, Clerk
By _____
Deputy

DEFENDANT JOE D. KINLAW'S MOTION TO VACATE FINAL JUDGMENT AGAINST HIM AND MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Defendant Joe D. Kinlaw ("Kinlaw"), pursuant to Fed. R. Civ. P. Rules 60(b)(4), 60(b)(5) and 60 (b)(6), files this Motion to Vacate Final Judgment Against and Memorandum of Points and Authorities in Support Thereof.

I.

PRELIMINARY STATEMENT

Joe Kinlaw requests that this Court vacate the Final Judgment against him in this case because (i) the judgment is void by reason of the Court's lack of subject matter jurisdiction over the claims of the Securities and Exchange Commission ("SEC"), (ii) the interlocutory Agreed Order of Permanent Injunction and Other Equitable Relief upon

which the judgment against Kinlaw was based, was interlocutory in nature, and upon the Court's dismissal of the case, should have been vacated, (iii) the Amended Final Judgment converting the interlocutory Agreed Order of Permanent Injunction to a Final Judgment of Permanent Injunction was not consented to by Kinlaw, and (iv) the law and facts upon which the Interlocutory Order of Permanent Injunction is based have changed.

II.

PROCEDURAL HISTORY

On July 27, 1995, pursuant to a Consent and Undertaking filed with the Court on July 20, 1995, this Court entered an interlocutory Order of Permanent Injunction and Other Equitable Relief against Kinlaw (the "Kinlaw Interlocutory Order"). While the Kinlaw Interlocutory Order, at Sections I and IV, imposes an injunction against Kinlaw from certain activities, Sections V and IX of the Kinlaw Interlocutory Order related to matters which remained unresolved as between Kinlaw and the SEC and thus, remained unadjudicated by the Court. Indeed, Kinlaw and the SEC never reached agreement on the issues which remained outstanding in the Kinlaw Interlocutory Order (discouragement and penalties) nor did the SEC ever file an application for discouragement or penalties, nor did it ever seek to set a hearing before the Court to determine discouragement or penalties.

The trial in this case was held in March, 1998 and the Court's Findings of Fact and Conclusions of Law were issued on July 21, 1999. Thus, the SEC had more than two and one-half years from the date of the Kinlaw Interlocutory Order to resolve the issues which remained open in that Order and to obtain a Final Judgment. The Kinlaw Interlocutory Order is neither styled as, nor intended to be, a Final Judgment.

Recognizing that the Kinlaw Interlocutory Order was just that, interlocutory, the Court on July 21, 1999 issued an Order Concerning Amended Final Judgment (the "Court's Amendment Order") requesting briefs from the parties, presumably pursuant to Rule 59(e) of the Federal Rules of Civil Procedure.[1]

In response to the Court's Amendment Order, Kinlaw filed his Motion to Amend the Final Judgment and Memorandum of Points and Authorities in Support Thereof. The Court on August 6, 1999, granting in part and denying in part Kinlaw's Rule 59(e) motion, issued its "Final Judgment," essentially reforming the Kinlaw Interlocutory Order into the Kinlaw Final Judgment of Permanent Injunction (the "Kinlaw Final Judgment"), but eliminating any orders of discouragement or penalties. Thus, the Court converted what had been an agreed interlocutory order into a permanent, non-consented to, Final Order of Permanent Injunction with respect to Joe D. Kinlaw.

Notwithstanding the foregoing, it is respectfully submitted, based upon the authorities cited herein, that the Kinlaw Final Judgment issued by this Court on August 6, 1999 against Joe D. Kinlaw is invalid and should in all respects be vacated.

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[1] Although the Court did not label the Court's Amended Order as requesting a Rule 59(e) Motion to Alter or Amend the Judgment, since the Court was questioning the correctness of the Final Judgment issued on July 21, 1999 and asking for counsels' input, the Court's Order of July 21, 1999 requesting counsels' input should properly be treated as the Court's own Motion to Alter or Amend the Judgment. *Aybar v. Krispin- Reyes*, 118 F..3d 10, 14 n.3 (1st Cir. 1997).

III.

THE INJUNCTIONS AGAINST KINLAW SHOULD BE VACATED

The Kinlaw Final Judgment should be vacated because the Court lacks subject matter jurisdiction over the claims of the SEC, because the Kinlaw Interlocutory Order was never severed from this case, and because the Kinlaw Final Judgment was not consented to.

Pursuant to Rule 60 (b) of the Federal Rules of Civil Procedure, the Federal Court may "relieve a party... from a final judgment, order or proceeding... [if](4)(the judgment is void; (5) the judgment has been satisfied, released, or discharged or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective applications; or (6) any other reason justifying relief from the operation of the judgment."

The United States Supreme Court captured the principal best in *Agostini v. Felton*, 117 S.Ct. 1997, 2006 (1997) when it stated:

> [I]t is appropriate to grant [an FRCP] 60(b)(5) motion when the party seeking relief from an injunction or consent decree can show 'a significant change either in factual conditions or the law.' *A court may recognize subsequent changes in either statutory or decisional law.* A court errs when it refuses to modify an injunction or consent decree in light of such changes (Emphasis added)

Id.

In this case, the Kinlaw Final Judgment should be vacated for any one of several reasons. First and foremost, this Court lacks subject matter jurisdiction over the SEC's Complaint because the Joint Venture interests are not securities. Thus, the Kinlaw Final Judgment, on its face, is void and accordingly pursuant to Fed. R. Civ. P. 60(b)(4),

should be vacated. Unlike other motions under Rule 60(b) regarding which the Court has discretion, Rule 60(b)(4) offers the Court no discretion. Simply stated, when the motion to vacate is based upon a void judgment, the Court has only one consideration: whether the judgment was or was not void. If void, the Court has no discretion and must vacate the judgment. *Recreational Prop. Inc. v. Southwest Mortgage Serv. Corp.*, 804 F.2d 311, 313 (5th Cir. 1986).

In this case, the Court held that the Joint Venture interests about which the SEC filed suit were not securities *and* that the Court lacked jurisdiction over the subject matter of this case. *See* Findings of Fact and Conclusions of Law.

There can be no question that a judgment entered by a court without subject matter jurisdiction is void. *Carter v. Fenner*, 136 F.3d 1000 (5th Cir. 1998). In Carter v. Fenner, the Fifth Circuit specifically stated that a judgment is void "if the court that rendered it lacked jurisdiction of the subject matter,...." *Id.* at 1006.

Although Kinlaw and the SEC agreed that the Court had jurisdiction with respect to issuing the Kinlaw Interlocutory Order, when the Court considered its Rule 59(e) motion and the possibility of converting the Kinlaw Interlocutory Order into the Kinlaw Final Judgment, the Court at that point had already ruled that it lacked subject matter jurisdiction. Moreover, Kinlaw's agreement as to the Court's jurisdiction with respect to the Kinlaw Interlocutory Order could not, under any circumstances, confer jurisdiction for the Kinlaw Final Order. It is axiomatic that parties cannot agree to confer on a federal court jurisdiction with which that court was not lawfully vested. *Marathon Oil v. Ruhrgas*, 145 F.3d 211, 217 (5th Cir. 1998).

Instructive in this analysis is *SEC v. Bennett*, 889 F. Supp. 804 (E.D. PA 1995), in which the SEC sought the entry of a negotiated consent order granting a preliminary injunction against one of the defendants. Despite the fact that the parties had mutually agreed to the issuance of a

preliminary injunction, the court, nevertheless, conducted an analysis to determine whether it had subject matter jurisdiction to issue such an order. *Id.* at 806. Although the *SEC v. Bennett* court ultimately found that the instruments in question were securities and, thus, that it had subject matter jurisdiction over the action, the case demonstrates that, had the court determined that the instrument in question was not a security, it would have lacked jurisdiction to enter the consent order.

In this case, the Court has already ruled that the Joint Venture interests in question are not securities and that the Court lacks jurisdiction over the subject matter of the action. The Kinlaw Final Judgment was issued more than two (2) weeks after this Court ruled that it lacked subject matter jurisdiction over the SEC's claims. Thus, the Kinlaw Final Judgment should be vacated. *See also Albert Trostel & Sons Co. v. Vanlente*, 1993 U.S. Dist. LEXIS 6863 (W.D. Mich. March 24, 1993) (wherein the district court ruled that it had no jurisdiction over the subject matter of the action and thus dismissed the complaint, an interim protective order and a consent order of temporary injunction).

The SEC will no doubt argue that it is too late for Kinlaw to contest the Court's jurisdiction. However, a party can always challenge subject matter jurisdiction, regardless of the existence of a consent judgment. *Local No. 93, International Association of Firefighters, the City of Cleveland*, 478 U.S. 501, 525 (1986) ("A consent decree must spring from and serve to resolve dispute within the Court's subject matter jurisdiction."); *Swift and Co. v. United States*, 276 U.S. 311, 314 (1928) ("Consent cannot confer jurisdiction to act outside the judicial power."). In this case, however, Kinlaw did not consent to the Kinlaw Final Judgment. Rather, he consented to an interlocutory order, which by its very terms was not dispositive of all issues. There never was a final judgment agreed to or entered into between Kinlaw and the SEC. The parties cannot by agreement confer subject matter jurisdiction

when it otherwise does not exist. Thus, notwithstanding any claim by the SEC that Kinlaw consented to the Court's jurisdiction of the subject matter of this case, such agreement does not, indeed cannot, confer subject matter jurisdiction.

The Court's Findings of Fact and Conclusions of Law are dispositive of all of the SEC's claims in this case. That disposition applies to Kinlaw pursuant to collateral estoppel and law of the case. In discussing the concept of collateral estoppel, the United States Supreme Court stated:

> Collateral estoppel, like the related doctrine of res judicata, has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and promoting judicial economy by preventing needless litigation.

Parklane Hosiery Company, Inc. v. Shore, 439 U.S. 322, 99 S.Ct. 645, 649, (1979) (citation omitted).

An analysis of the *Parklane Hosiery v. Shore* opinion is particularly instructive in this case. In *Parklane Hosiery*, a stockholders' class action was brought against Parklane Hosiery. However, before the action came to trial, the SEC sued the same defendants alleging facts very similar to the class action allegations. *See SEC v. Parklane Hosiery Co.*, 422 F. Supp. 477. In *SEC v. Parklane Hosiery*, the SEC obtained a declaratory judgment against Parklane Hosiery, which included findings of violations of the federal securities laws. In *Shore v. Parklane Hosiery*, the class action plaintiff moved for summary judgment on the basis of the SEC injunction claiming that Parklane Hosiery was collaterally estopped from denying liability.

The Supreme Court in *Parklane Hosiery v. Shore* recognized that the scope of collateral estoppel was somewhat limited by the doctrine of mutuality of the parties. *Id.* at 649. The Court deviated from that concept, however, in ruling that notwithstanding that, long accepted principle,

the doctrine of collateral estoppel did preclude Parklane Hosiery from interposing a defense to the class action complaint because it had been subject to a declaratory judgment in a complaint brought by the SEC.

In the case before this Court, Kinlaw had always been a party to this action, the issues with respect to Kinlaw are identical to the issues resolved with respect to the Defendants who tried the case. In all respects therefore, if the Joint Venture interests are not securities as to the Defendants who tried the case, they cannot be securities as to any Defendant, including Kinlaw. Thus, since there could not have been a judgment in favor of the SEC against the Defendants who tries the case, there cannot be a judgment in favor of the SEC against Kinlaw.

The vacature of the Kinlaw Final Judgment is equally appropriate under Fed. R. Civ. P. 60(b)(5) and/or (6). It is well settled that, whether an order has been entered after litigation or by consent, "a Court does not abdicate its power to revoke or modify its mandate if satisfied that what it has been doing has been turned through changing circumstances into an instrument of wrong." *Swift*, 286 U.S. at 114.

IV.

CONCLUSION

In view of the foregoing, it is respectfully submitted that the Court vacate the Amended Final Judgment as against Joe D. Kinlaw.

Respectfully submitted,

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ATTORNEYS FOR
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CERTIFICATE OF CONFERENCE

I hereby certify that on February 1, 2000, the undersigned telephoned Mr. Jeffrey Norris, counsel for the SEC, to confer regarding the within Motion. Mr. Norris was not available and I left a voice mail message. I anticipate that the SEC will oppose the Motion.

/s/_____
Joel Held

CERTIFICATE OF SERVICE

I hereby certify that the foregoing document was served via regular mail on the 2nd day of February, 2000 as follows:

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U.S. Court of Appeals
FILED
Jun. 21, 2001
Charles R. Fulbruge III, Clerk

Case No. 00-10568

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION
Plaintiff-Appellee,
v.
KINLAW SECURITIES CORPORATION, ET AL,
Defendants
JOE D. KINLAW; STEPHEN R. PARKER;
DYKE FERRELL,
Defendants-Appellants.
On Appeal from the United States District Court
for the Northern District of Texas
Dallas Division

PETITION FOR REHEARING OF DEFENDANT-APPELLANT, JOE D. KINLAW

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ARGUMENT AND AUTHORITIES

A. Summary

Appellant Joe D. Kinlaw ("Kinlaw") respectfully submits this Petition for Rehearing based upon the Panel's May 14, 2001 decision which contains an apparent misapprehension of the standard of review on a Rule 60(b)(4) Motion to Vacate. Specifically, the Panel affirmed the District Court's decision because "the district court did not abuse its discretion in denying the Rule 60 motions at issue."[1] Although abuse of discretion is the appropriate standard of review in Rule 60(b)(5) and 60(b)(6) cases, the proper standard in Rule 60(b)(4) cases is *de novo*. Accordingly, Kinlaw respectfully requests a Rehearing of this matter by the Panel, a *de novo* review of the District Court's decision on Kinlaw's Rule 60(b)(4) Motion, and a reversal of the District Court's denial of Kinlaw's Rule 60(b)(4) Motion.

B. Background

On February 2, 2000, Kinlaw filed a Motion to Vacate Final Judgment and Memorandum of Points and Authorities in Support thereof pursuant to Federal Rules of Civil Procedure 60(b)(4), 60(b)(5), and 60(b)(6). (R. 04929-04937). On April 10, 2000, the District Court issued its Order Denying Kinlaw's Rule 60(b) Motion. (R. 05019-05025). The District Court's Order was primarily based upon Kinlaw's argument under Rule 60(b)(4) that the District Court lacked subject matter jurisdiction to enter a Final Judgment of permanent injunction against Kinlaw. (R. 05021-05024).

Thereafter, Kinlaw timely filed his Notice of Appeal (R. 05026-05027).

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[1] Pursuant to Fifth Circuit Rule 40.1, an unmarked true and correct copy of the Court's decision is attached hereto.

C. Standard of Review

The standard of review for a district court's ruling on a Rule 60(b)(4) motion is *de novo*. *Carter v. Fenner*, 136 F.3d 1000, 1005 (5th Cir.), cert. denied, 525 U.S. 1041 (1998). "Unlike motions pursuant to other subsections of Rule 60(b), Rule 60(b)(4) motions leave no margin for discretion as the judgments themselves are by definition either legal nullities or not." *Carter*, 136 F.3d at 1005. In its Brief, the Securities and Exchange Commission agreed with Kinlaw that the standard of review for 60(b)(4) motions was *de novo*.[2]

Nevertheless, the Panel's decision found that the District Court did not "abuse its discretion" in denying Kinlaw's Rule 60(b) motions. Because Kinlaw's Rule 60(b)(4) Motion should have been reviewed *de novo*, Kinlaw respectfully requests a Rehearing of the District Court's denial of that Motion, and a *de novo* review of the District Court's Order.

CONCLUSION

For the reasons set forth herein, Kinlaw respectfully requests a Rehearing from the Panel and a *de novo* review of the District Court's Ordering denying Kinlaw's Rule 60(b)(4) Motion to Vacate Final Judgment. Further, Kinlaw respectfully requests that, upon *de novo* review, and based upon the facts, arguments and authorities presented in Kinlaw's Brief[3] and Reply Brief[4] and at oral

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[2] Brief of the Securities and Exchange Commission, Plaintiff-Appellee, p. 14 n.6.

[3] August 26, 2000 Brief of Defendant-Appellant, Joe D. Kinlaw.

[4] November 13, 2000 Reply Brief of Defendant-Appellant, Joe D. Kinlaw.

argument, the Panel reverse the District Court's Order, and dismiss the permanent injunction against him.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct paper and disk copy of the foregoing Petition for Rehearing has been mailed on this day of June, 2001, to:

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CERTIFICATE OF COMPLIANCE

Pursuant to 5th CIR. R. 32.2 and .3, the undersigned certifies this brief complies with the type-volume limitations of FED. R. APP. 32(a)(7).

1. EXCLUSIVE OF THE EXEMPTED PORTIONS IN 5th CIR. R. 32.2, THE BRIEF CONTAINS (select one):

A. 881 words, OR

B. lines of text in monospaced typeface.

2. THE BRIEF HAS BEEN PREPARED (select one):

A. in proportionally spaced typeface using:
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/s/ _____
Joel Held